Committee on Resources,

Subcommittee on Energy & Mineral Resources

energy - - Rep. Barbara Cubin, Chairman
U.S. House of Representatives, Washington, D.C. 20515-6208 - - (202) 225-9297

Witness Statement

Testimony
Of
Mark B. Murphy
On Behalf Of The
Independent Petroleum Association of America,
And The
National Stripper Well Association,
Before The
Subcommittee on Energy and Mineral Resources
House Resources Committee
U.S. House of Representatives
April 25, 2001

STATEMENT OF Mark MURPHY
FOR THE
INDEPENDENT PETROLEUM ASSOCIATION OF AMERICA
AND THE
NATIONAL STRIPPER WELL ASSOCIATION
AND

California Independent Petroleum Association
Colorado Oil & Gas Association
East Texas Producers & Royalty Owners Association
Eastern Kansas Oil & Gas Association
Florida Independent Petroleum Association
Illinois Oil & Gas Association
Independent Oil & Gas Association of New York
Independent Oil & Gas Association of Pennsylvania
Independent Oil & Gas Association of West Virginia
Independent Oil Producers Association Tri-State
Independent Petroleum Association of

Michigan Oil & Gas Association
Mississippi Independent Producers & Royalty Association
Montana Oil & Gas Association
National Association of Royalty Owners
Nebraska Independent Oil & Gas Association
New Mexico Oil & Gas Association
New York State Oil Producers Association
Ohio Oil & Gas Association
Oklahoma Independent Petroleum Association
Panhandle Producers & Royalty Owners Association
Pennsylvania Oil & Gas Association
Permian Basin Petroleum Association

Independent Petroleum Association of Mountain States
Independent Petroleum Association of New Mexico
Indiana Oil & Gas Association
Kansas Independent Oil & Gas Association
Kentucky Oil & Gas Association
Louisiana Independent Oil & Gas Association
Tennessee Oil & Gas Association
Texas Alliance of Energy Producers
Texas Independent Producers and Royalty Owners
Wyoming Independent Producers Association

Madam Chairwoman, members of the committee, I am Mark Murphy, President of Strata Production Company of Roswell, New Mexico. Strata is a small independent oil and gas exploration and production company. Most of our operations are located on Federally managed lands in Southeastern New Mexico. My family has been in the oil and gas business for four (4) generations. We have been involved in projects throughout the United States, especially throughout the Rocky Mountain region. I have been a westerner all of my life. To me, enjoyment of our natural wonders and good stewardship of our lands is a way of life. Commitment to the environment was taught to me by my parents and is being taught, by me, to my children.

I am an avid outdoorsman; I love to hike, camp, fish and hunt and do so at every opportunity. I have to admit that I'm surprised by those who claim to love the land more than I do – or those who claim that the oil and gas industry has or intends to harm the environment. I know otherwise and I believe most of you do too. I 'm not trying to suggest that just because people like me live, work and play on these lands that we have all the answers. But, I do submit that the oil and gas industry has an excellent record of developing petroleum and natural gas resources in a safe and environmentally sensitive manner. There is no single solution to our Nation's energy crisis. It will take the development of new resources, conservation, and utilization of renewable sources as well.

On April 3, 2001, the Congressional Sportsman's Caucus, sent Barry Russell, President of IPAA a letter expressing concern that previous testimony presented by Neal Stanley, the current President of the Independent Petroleum Association of Mountain States, was not consistent with a majority of the oil and gas industry who seek to minimize the footprint of their developments – especially the temporary impacts to the wildlife that inhabit the area. On behalf of all independent producers, I would like to set the record straight. We are careful stewards of the land with the greatest respect for the preservation of wildlife. We are sportsmen, so we know that sportsmen pay fees that ensure wildlife remain in abundance. As well, as oil and gas men, we conduct our activities in a way that supports wildlife. However, we need to strike a balance between development and the environment thereby allowing us to continue to provide clean and reliable energy for many decades to come while enjoying the abundance of wildlife. One activity should not take precedence over the other. They can, and do, co-exist. I'll talk more about this later in my testimony.

Today, I am testifying on behalf of the Independent Petroleum Association of America (IPAA), the National Stripper Well Association (NSWA), and 32 cooperating state and regional oil and gas associations. These organizations represent the thousands of independent petroleum and natural gas producers that drill 85 percent of the wells drilled in the United States. This is the segment of the industry that is damaged the most by the lack of a domestic energy policy that recognizes the importance of our own national resources. NSWA represents the small business operators in the petroleum and natural gas industry, producers with "stripper" or marginal wells. These producers are the linchpins to continued development of domestic petroleum and natural gas resources.

As I understand it, today's hearing will focus on the oil and gas permitting process on federal lands administered by the Bureau of Land Management ("BLM") and the US Forest Service (USFS). This testimony will focus first on several key factors that influence future energy issues. Second, it will describe issues that are specifically related to permitting delays and suggest solutions.

A Nation Dependent on Fossil Fuels

Like it or not, the nation will be dependent on fossil fuels for the foreseeable future. In particular, petroleum and natural gas currently account for approximately 65 percent of the nation's energy supply – and will continue to be the significant energy source. Natural gas demand, for example, is expected to increase by more than 30 percent over the next decade.

Independent Producers – The Linchpin to Future Domestic Petroleum and Natural Gas

It is important to recognize that the domestic oil and natural gas industry has changed significantly over the last fifteen years. The oil price crisis of the mid-1980's and policy choices made then triggered an irreversible shift in the nature of the domestic industry. Independent producers of both oil and natural gas have grown in their importance, and that trend will continue. Independent producers produce 40 percent of the oil – 60 percent in the lower 48 states onshore – and produce 65 percent of the natural gas. They are becoming more active in the offshore, including the deep water areas that have previously been the province of the large integrated companies. At the same time those large companies are now mainly focusing their efforts overseas, in addition to Alaska and the offshore, because they are aiming their investments to seek new and very large fields. Domestic energy policy must recognize this reality.

Recognizing The Role of The Market

Future energy policy should rely on market forces to the greatest degree possible. For natural gas the market is strong and active. Natural gas supply is essentially North American and overwhelmingly from two countries that rely on private ownership and the free market – the United States and Canada. Currently, exploration and development of natural gas in both countries is being aggressively pursued when the opportunities are there, and can be accessed. In the United States drilling rig counts for natural gas are running at rates that are as high as they have ever been since natural gas drilling was distinguished from petroleum. The principal constraints are finding the capital to invest, getting access to the resource base, finding competent personnel, and obtaining rigs. If the market is allowed to work, it will continue to draw effort to produce this critical resource for domestic consumption.

Oil, however, is a different situation. In making decisions regarding developing domestic petroleum resources, the nature of the world petroleum market must be recognized. Although the United States remains the second or third largest producer of petroleum, it is operating from a mature resource base that makes the cost of production higher than in competitor nations. More importantly, most other significant petroleum producing countries rely on their petroleum sales for their national incomes. For them, petroleum production is not driven by market decisions. Instead, their policies and their production are determined by government decisions. Most are members of OPEC, the Organization of Petroleum Exporting Countries. Several are countries hostile to the United States like Iraq, Libya, and Iran. Even those that are generally supportive of the United States, like Saudi Arabia and Kuwait, are susceptible to unrest from both internal and external forces.

Thus, the market price for petroleum will be largely framed by production decisions driven not by the market, but by the politics of these countries – both by internal issues and global objectives. United States domestic policy decisions must reflect this reality – looking to this factor in taking actions that can affect domestic production and producers. But, more importantly, it must recognize that a healthy domestic <u>oil</u> production industry is also essential for a healthy domestic <u>natural gas</u> industry, <u>because they are inherently intertwined</u>.

For example, the failure of the United States to recognize the need to respond to the low oil prices of 1998-99 resulted in adverse consequences for both oil <u>and</u> natural gas production. The nation has lost about 10 percent of its domestic oil production – most of which has been made up by imports from Iraq. And, in addition, the tight natural gas supplies this year are partially attributable to the drop in natural gas drilling in 1998-99 when oil prices were low and capital budgets for exploration and production of both oil and natural gas were slashed by producers because drilling under those conditions made no economic sense.

The Federal Role

The predominant areas where the federal government plays a major role in promoting or inhibiting domestic oil and natural gas production are: providing access to the natural resource base and providing access to essential capital.

I. Access and Permitting Constraints

National energy policy must also recognize the importance accessing the natural resource base. In 1999 the National Petroleum Council in transmitting its *Natural Gas* study concluded:

> *The estimated natural gas resource base is adequate to meet this increasing demand for many decades…. However, realizing the full potential for natural gas use in the United States will require focus and action on certain critical factors.*

Much of the nation's natural gas underlies government-controlled land both offshore and onshore. Policies in these areas have constrained or prohibited access largely based on fears of environmental harm. But, these resources <u>can</u> be developed in an environmentally sound and sensitive manner. The Department of Energy recently released a comprehensive report, *Environmental Benefits of Advanced Oil and Gas Exploration and Production Technology*, demonstrating that the technology is available. And, it is being employed, when exploration is allowed.

Without policy changes, the nation may not be able to meet its needs. The NPC study projects demand increasing by over 30 percent during the next fifteen years. This will require not only finding and developing resources to meet this higher demand, but also to replace the current depleting resources. While many analysts are focusing on how much more natural gas demand will grow, it is equally important to recognize what is happening to existing supply. All natural gas wells begin to deplete as soon as they start producing. However, as our technology has improved, we now are able to identify probable reservoirs more effectively. This allows us to find and more efficiently produce smaller fields.

Onshore, the NPC *Natural Gas* study estimates that development of over 137 TCF of natural gas under government-controlled land in the Rocky Mountains is restricted or prohibited. A recent study by the Energy Information Administration concludes that about 108 TCF are under restriction. Regardless, the amount is significant. An inventory of these resources is underway. It is an important first step. But, it is equally important to understand that access to these resources is limited by more than just moratoria. The constraints differ. Monument and wilderness designations clearly prohibit access to some areas. Regulations like the Forest Service "roadless" policy and prohibitions in the Lewis and Clark National Forest are equally absolute.

At the same time the permitting process to explore and develop resources often works to effectively prohibit access. These constraints range from federal agencies delaying permits while revising environmental impact statements to habitat management plans overlaying one another thereby prohibiting activity to unreasonable permit requirements that prevent production. There is no single solution to these constraints. What is required is a commitment to assure that government actions are developed with a full recognition of the consequences to natural gas and other energy supplies. IPAA believes that all federal decisions – new regulations, regulatory guidance, Environmental Impact Statements, federal land management plans – should identify, at the outset, the implications of the action on energy supply and these implications should be clear to the decision maker. Such an approach does not alter the mandates of the underlying law that is compelling the federal action, but it would likely result in developing options that would minimize the adverse energy consequences.

While industry has the expertise and technology to develop new reserves we can only utilize these tools if permitted access by the Federal regulatory and management agencies. Allow me to relay some real life situations that I'm aware of in Southern New Mexico

As previously stated, I understand that the issue of seasonal restrictions on species range has been discussed in previous hearings and follow up correspondence. Let me take this opportunity to clear up any confusion concerning IPAA's position on this important issue. First, we are not aware of any operator who believes that oil and gas exploration should interfere with a critical range of any species. We think appropriate restrictions should address issues identified by scientific and factual investigation. However, industry is concerned that Federal land managers generally impose excessively onerous restrictions over unnecessarily large geographic areas. A case in point involves what are known as Prairie Chickens, which inhabit much of the Great Plains including portions of Southeastern New Mexico. The BLM has imposed a moratorium on operations from April through June of each year. Without any scientific basis the BLM maintains that field operations disrupt the Prairie Chicken's mating, or as it is referred to "booming", season. My personal field experience leads me to disagree with that assumption but, be that as it may, BLM has imposed this moratorium on approximately 380,000 acres. After industry insisted upon a scientific study BLM has now indicated that it may reduce this area to approximately 196,000 acres. Industry does not object to reasonable restrictions in areas where species are truly being affected by its activities. We do object to unfounded restrictions on overly broad geographic areas.

Another example involves my company, which made a significant oil and gas discovery at the Nash Draw Unit located just east of Carlsbad, New Mexico. We estimate that the field may contain as much as 30 million barrels of oil and 33 BCF of natural gas. Due to surface access restrictions, including the presence of shallow salt water (playa) lakes, we were only able to develop a portion of the reservoir with conventional vertical drilling. Not being able to fully evaluate the extent of the reservoir, we conducted a high resolution 3-D seismic survey. The survey revealed that the best, and probably, the most prolific portion of the reservoir appears to exist outside the area where vertical drilling is allowed. To access this new area requires the drilling of directional wellbores that are then further deviated horizontally. If successful, the application of this known technology, which has yet to be applied in this area, will allow us to fully develop this important new source of petroleum. In addition, if successful, this process could allow development of tens of thousands of acres that are currently off limits to conventional drilling practices.

As we prepared to drill the well we faced what many operators are facing today, unavailability of drilling rigs, of experienced personnel, and of special equipment. Unfortunately, at the same time, our federally approved drilling permit was due to expire on April 1, 2001. On March 6, 2001 we requested an extension from the BLM. In the alternative, we suggested that we would commence operations by building the necessary road and well pad, and we would set surface conductor pipe in order to prevent the drilling permit from expiring. The BLM office in Roswell told us that, in its opinion, our activities would perpetrate the drilling permit. However, we were also told to check with the Resource Area office, located in Carlsbad, New Mexico, as it was within that office's discretion to approve or disapprove our proposal. Upon checking we were told that our proposal was unacceptable and, that extension could take up to nine (9) months. The alternative, we were told, was to commence drilling operations. Anticipating that a deep rotary rig would be available soon, and that we couldn't move it on location with an expired drilling permit, we commenced drilling with a shallow cable tool rig. Depending upon when the deep rotary rig becomes available we estimate this additional, and in our view, unnecessary cost will total $25,000 to $50,000. These are funds that we could have used to develop additional sources of natural gas and oil.

Another example of unnecessary and costly delays by the BLM is in Southeastern New Mexico, northeast of El Paso, Texas. HEYCO, a local operator, initiated exploration work in this rank wildcat area. Areas such as this one must be explored if we are going to meet this country's natural gas demand. HEYCO began exploration and leasing in this area in the early 1980's. In 1996 HEYCO formed a federal exploratory unit in Otero County. An application to drill was approved by the district office of the BLM in Roswell, New Mexico, in May 1996 and an initial exploratory well was drilled and completed as a producer on August 3, 1997.

Subsequently, HEYCO nominated additional federal lands for leasing. The BLM declined to offer those lands for public sale. In January 1998, HEYCO applied for additional locations for the purpose of confirming its discovery and to determine the size of gathering system necessary to transport natural gas to an El Paso natural gas transmission line approximately 14 miles to the south.

Eleven MONTHS later, HEYCO was informed by the BLM that the drilling permits for the confirmation wells were approved but onerous stipulations conditioned this approval. The BLM also informed HEYCO that, notwithstanding approval to drill, approval to produce was not granted.

The basis of BLM opposition to development of the natural gas resources in the Orogrande Basin has ranged from the suggested presence of an endangered species (the Aplamado Falcon) to the resource value of native grass. One sighting of the falcon was noted during the last 50 years until seven sightings were reported by a BLM employee (with no witnesses) subsequent to the HEYCO discovery.

After some 30 months of study the BLM released, in November 2000, a draft Environmental Impact Statement/Resource Management Plan (EIS/RMP) which, when approved, would become the basis for further oil and gas activity on federal lands in the Orogrande Basin. The document proposes three alternatives that severely restrict surface use and would render exploration and development of natural gas uneconomic. This planning document could potentially deny access to over 1 trillion cubic feet of gas equivalents.

BLM would deem this land "accessible." Why? Because they propose that all wells drilled should be directionally drilled from existing roads. However, given the depth of the target formation, it is physically impossible to drill directional wells in the area. So, when some claim that 95% of federal lands are available for development, they may want to drill a little deeper in to the facts and determine if drilling can physically occur under the stated stipulations. There is a big difference between regulatory defined "access" and practical access. Again, this is why an accurately inventory is needed to determine what lands are truly accessible or not.

What is even more frustrating with public lands management, is that in many cases, the BLM ignores the views of the state and the people who live in the area. This holds true for the Otero County example. Based on recent public hearings, it appears local authorities are very much in support of drilling in this area and state officials were not consulted in the planning process. One quick fix in the area of land access is to turn to the states and the people who live in those states. They need to be part of the process.

In Southwestern Lea County, New Mexico, a local BLM geologist has determined that operators must now set 700 to 800 additional feet of surface casing at an estimated incremental cost of $30,000 to $40,000 per well. This changes a practice that has been followed in the drilling of hundreds, if not thousands, of wells in this area. The BLM geologist is apparently concerned that the drilling of wells may contaminate water zones in this area. Such zones have not been proven to exist nor has the Oil Conservation Division, the New Mexico regulatory agency constitutionally mandated to protect ground water, stated a similar concern or even proposed modifying its long-standing surface casing requirements. Here a single individual can, without scientific proof or factual basis, literally cost the industry thousands, if not ultimately millions, of dollars.

It is clear that Federal land managers have not been given clear instructions that they must consider the impact of their actions on energy development. Therefore, each manager is left to assign his or her own value to the importance of energy development on a case-by-case basis. The focus of land management practices has been on process not on what ultimately is in the best interest of our Nation.

There are hundreds and hundreds of these unnecessarily leasing and approval delays up and down the Rockies. To have meaningful "access" to even part of the approximately 350 tcf's in the Rockies, IPAA recommends the following:

> Support of President Bush's and Secretary Norton's FY 2002 budget pertaining the following items:

- A $7.1 million increase to support improvements in the land use planning and accelerate the multi-year process of updating management plans. This is a good first step. The entire planning process needs to be reviewed, including the funding process.
- An $11.8 million increase for oil and gas programs, including energy resources surveys, Alaska North Slope oil and gas exploration, coal-bed methane permits, and oil and gas inspections.
- A $3.0 million dollar increase for BLM to work with USGS, the USFS, and the Department of Energy to conduct an inventory of public lands and describe the impediments and restrictions to access and development. Madam Chairwoman, you, along with Chairman Skeen, led the effort in the House for getting this included in EPCA, which was signed into law late last year.
- A $2.0 million dollar increase to accelerate leasing by 15 percent and to process an additional 1,000 to 2,000 drilling permits in the most promising areas.

> With respect to improving onshore land access, support of the following provisions of the National Energy Security Act of 2001, S.388:

  - Section 101 is the single most important section of the S.388. It requires energy accountability when federal agencies make decisions affecting energy supply.

- Subsection D – Improvements to Federal Oil and Gas Lease Management – This section contains a number of very important reforms. It allows a state, if willing, to conduct a number of non-environmental oil and gas approvals on behalf of the federal government. Time and time again, we see that the state can perform oil and gas activities at a much lower cost and in much more timely fashion than the federal government. For decisions remaining with the federal government, the bill establishes reasonable timeframes for processing different documents related to oil and gas development. Additionally, it provides adequate funding for environmental documents. Timing is capital and if there are never-ending delays, this capital will be directed overseas or to private lands.
- Section 310 – Program on Oil and Gas Royalties In Kind. By giving more tools to the federal government to maximize return to the American taxpayer when taking in kind, the program can be expanded. When royalty in-kind is expanded, more certainty is provided to the government and the oil and gas lessees; thereby making federal lands more attractive for development.

Encourage the Administration to determine which of these provisions in S. 388 it could implement immediately. Other administrative improvements that Administration needs to consider include:

- Prohibiting cost recovery regulations that would place unnecessary costs on every facet of the oil and gas program. These costs will further discourage small independent producers from developing onshore federal lands and are inappropriate given the billions of dollars the oil and gas industry pays each year to the federal government in the form of royalties.
- Stopping all regulation rewrite efforts that were mandated by Vice President Gore for the so-called purpose of putting things into "Plain English." The drafts issued of the oil and gas onshore oil and gas regulations during the Clinton Administration proposed significant policy changes and would result in more uncertainty. Specifically, smaller independent producers are concerned about the proposed increase of bonding amounts. Bonds are rarely called for the purpose of reclamation. The vast majority of good operators on federal land should not be punished for the bad behavior of the few. Enforcement is the key.

II. Providing Access to Essential Capital

Because this hearing is primarily focused on the problem of permitting delays, this testimony will only touch on the capital issue. Because oil and natural gas exploration and production are capital intensive and high-risk operations that must compete for capital against more lucrative investment choices, much of its capital comes from its cash flow. The federal tax code plays a critical role in determining how much capital will be retained. The Administration and Congress need to enact provisions designed to (1) encourage new production, (2) maintain existing production, and (3) put a "safety net" under the most vulnerable domestic production – marginal wells. Congress has considered a mix of tax reforms that have widespread support. They include provisions to allow expensing of geological and geophysical costs and of delay rental payments that encourage new production, extending the net operating loss time frame and revising percentage depletion that assist both new and existing production, and a countercyclical marginal well tax credit when prices fall to low levels. All of these are programs that independent producers need because their revenues are limited to their production

Beyond these immediately needed policy changes, new tax policies must be developed to encourage renewed exploration and production needed to meet future demand, particularly for natural gas. In 1999 the National Petroleum Council released its *Natural Gas* study projecting future demand growth for natural gas and identifying the challenges facing the development of adequate supply. For example, the study concludes that the wells drilled in the United States must effectively double in the next fifteen years to meet the demand increase. Capital expenditures for domestic exploration and production must increase by approximately $10 billion/year – roughly a third more than today. Generating this additional capital will be a compelling task for the industry. As the National Petroleum Council study states:

> *While much of the required capital will come from reinvested cash flow, capital from outside the industry is essential to continued growth. To achieve this level of capital investment, industry must be able to compete with other investment opportunities. This poses a challenge to all sectors of the industry, many of which have historically delivered returns lower than the average reported for Standard and Poors 500 companies.*

In fact, as the past year has shown, capital markets have not shifted to supporting the energy sector. For the industry to meet future capital demands – and meet the challenges of supplying the nation's energy – it will need to increase both its reinvestment of cash flow and the use of outside capital. The role of the tax code will be significant in determining whether additional capital will be available to invest in new exploration and production in order to meet the $10 billion annual target.

There's No Short Term Fix – Recovery Will Take Time

Any realistic future energy policy will take time. There is no simple solution. The popular call for OPEC to "open the spigots" failed to recognize that the low oil prices of 1998-99 reduced capital investment from the upstream industry all over the world. Only Saudi Arabia had any significant excess production capacity and no one knew just how much or whether the oil was of a quality that it could be refined in most refineries. The collateral damage of low oil prices on the natural gas industry is affecting gas supply today and will until the industry recovers. The producing industry lost 65,000 jobs in 1998-99. While about 40 percent of those losses have been recovered, they are not the same skilled workers. If measured by experience level, the employment recovery is far below the numbers. Less obvious, but equally significant, during the low price crisis equipment was cannibalized by operating and support industries who were decimated. It will take time to develop the infrastructure again to deploy new drilling rigs and provide the skilled services that are necessary to rejuvenate the industry.

Conclusion

Providing access to the resource base will be critical and requires making some new policy choices with regard to federal land use. A critical first step is to require agencies to measure and document the impact of their decisions on the development of energy resources.

Overall, attracting capital to fund domestic production under these circumstances will be a continuing challenge. This industry will be competing against other industries offering higher returns for lower risks or even against lower cost foreign energy investment options. The slower the flow of capital, the longer it will take to rebuild and expand the domestic industry.

These two issues are the ones that are particularly dependent on federal actions, and should be the immediate focus of this Congress and the Administration.

It is time for this country to take its energy supply issues seriously and develop a sound future policy. Certainly, there is room in such a policy for sound energy conservation measures and protection of the environment. But, energy production – particularly petroleum and natural gas – is an essential component that must be included and addressed at once. Independent producers will be a key factor, and the industry stands ready to accomplish our goals, if policies reflect that reality.

# # #